

# CRS Report for Congress

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## **Tobacco-Related Programs and Activities of the U.S. Department of Agriculture: Operation and Cost**

Jasper Womach  
Agricultural Policy Specialist  
Resources, Science, and Industry Division

### **Summary**

The U.S. Department of Agriculture (USDA) has long operated programs that directly assist farmers and others with the production and marketing of numerous crops, including tobacco. In most cases, the programs themselves are not controversial. Increasingly, however, where tobacco is involved, the use of federal funds is being called into question. Taken together, all of the directly tobacco-related activities of the USDA generated net expenditures of an estimated \$199 million in FY2001, and the budget anticipates net revenues of \$43 million for FY2002.

The federally financed tobacco price support program is the major form of tobacco farmer assistance, which recently has been supplemented with quota loss payments and the acquisition of surplus tobacco inventories. The USDA is prohibited by language in the annual appropriations law from spending funds to help promote tobacco exports and to conduct research relating to production, processing, or marketing of tobacco and tobacco products. Other tobacco-related activities have been subjected to congressional scrutiny. The USDA does operate numerous programs that are not tobacco-specific, but are available to farmers that produce tobacco and other crops. These are not examined in this report.

## **Price Support Program**

### **Marketing Quotas and Loans**

The tobacco price support program is designed to raise and stabilize farm tobacco prices at a higher level than they would be otherwise. This is accomplished through a combination of two program features, marketing quotas and nonrecourse commodity loans.

The national marketing quota is the amount of tobacco judged sufficient to meet annual domestic and export demand, but at a price at least as high as the legally mandated support price. In other words, the production of tobacco is held below what it would otherwise be. By restricting production, farm income is supported through artificially higher market prices, causing buyers of tobacco (and ultimately the consumers) to bear the cost of the price support program.

In conjunction with marketing quotas, minimum selling prices are guaranteed to farmers through Commodity Credit Corporation (CCC) nonrecourse tobacco loans. At the auction sale barn, each lot of tobacco goes to the highest bidder, unless that bid does not exceed the government's loan price. In such a case, the farmer is paid the loan price by a price stabilization cooperative, with money borrowed from the CCC. The tobacco is consigned to the cooperative, which redries, packs, and stores the tobacco as collateral for the money borrowed from the CCC. The cooperative later sells the tobacco, with the proceeds going to repay the CCC—with interest.

Thus, the loan program provides a financing mechanism to store tobacco for long periods of time in order to balance supply with demand. In any given year, the budgetary impact of the loan program is the difference between loan outlays (new loans made) and loan recoveries (old loans repaid). In some years, loan repayments exceed new loan requests, resulting in revenues in excess outlays for the CCC. For FY2002, the loan activities are anticipated to result in net revenues of about \$97 million.

## **No-Net-Cost and Marketing Assessments**

Congress passed the No-Net-Cost Tobacco Program Act in 1982 (P.L. 97-218). This law mandates that the tobacco program be carried out at no net cost to taxpayers (other than administrative expenses common to all commodity support programs).

Costs arise when tobacco put under loan is later sold at a price insufficient to cover the loan principal plus accumulated interest. To cover all such losses, the law mandates an assessment on sellers and buyers at the wholesale level on every pound of leaf tobacco marketed. The assessment rate is administratively determined and the revenue is deposited in an off-budget account that is held to reimburse the CCC for any financial losses resulting from tobacco loan operations.

The no-net-cost rule has muted much of the criticism that taxpayers are subsidizing tobacco farmers. However, there is confusion over the appearance of tobacco spending in the budget. The annual budgetary impact of the tobacco loan program is determined primarily by loan outlays (new loans made) and loan recoveries (repayment of old loans). In any given year, new loan outlays may be more or less than old loan repayments. In the FY2002 budget, the sizable net revenue of nearly \$97 million is expected to result from the previously large loan outlays being repaid (\$159 million) compared to a modest level of new loan outlays being made (\$62 million). Since tobacco is typically stored for extended periods, it can be several years before the loan inventory is sold and debts are settled. In all cases, the law requires that any losses of loan principal and interest be reimbursed from no-net-cost assessments.

However, in 1986 and again in 2000, when accumulated loan inventories threatened the financial solvency of the no-net-cost fund, Congress transferred ownership of the

tobacco to the CCC and forgave the no-net-cost requirement. Disposal of these tobacco stocks cost CCC about \$376 million and \$555 million respectively.

## Administrative Operations

The tobacco price support program is administered by USDA's Farm Service Agency (FSA). Annual administrative costs are budgeted at about \$17 million in FY2002 for tobacco price support operations. This cost covers primarily salaries for a few headquarters personnel and substantial staff time devoted to the tobacco program in about 600 county offices. Critics point out that this administrative cost falls upon taxpayers, thus undermining the no-net-cost claims of program supporters.

A more detailed explanation of the tobacco price support program is found in Tobacco Price Support: An Overview of the Program, CRS Report 95-129. The Farm Service Agency provides detailed *Program Fact Sheets* for flue-cured, burley and other types of tobacco.

**Market Loss Payments and Disaster Assistance.** In response to low commodity prices in 1999, Congress authorized market loss payments to producers of grains, cotton, oilseeds, tobacco, dairy, and peanuts in FY2000. \$328 million was specified for tobacco growers. The funds were distributed as direct payments from CCC to tobacco producers in proportion to the amount each grower's quota was reduced in 1999 from the previous year. An additional \$2.8 million is being paid as compensation for flood-damaged tobacco on auction warehouse floors. Again, Congress approved \$350 million in market loss payments to tobacco growers for FY2001.

## Federal Crop Insurance

The federal crop insurance program, administered by USDA's Risk Management Agency, provides farmers with subsidized multi-peril insurance on tobacco and other crops. The insurance covers unavoidable production losses due to adverse weather, insect infestations, plant diseases, and other natural calamities. It does not cover avoidable losses caused by neglect or poor farming practices. Sales and servicing of policies are done by private companies with some federal reimbursement, and most of the net indemnity losses fall upon the government. Additionally, the premiums have been subsidized since 1980 in order to encourage participation and avoid enactment of *ad hoc* disaster assistance programs. Experimental Crop Revenue Coverage, available for wheat, corn, and soybeans, is not available for tobacco.

Total net federal expenditures for tobacco crop insurance coverage include outlays for crop loss indemnity payments, plus the premium subsidies, plus sales administrative expenses, less the farmer-paid premiums. Net federal outlays are estimated to be \$34 million in FY2001, and are budgeted at \$35 million for FY2002.

## **Tobacco Inspection and Grading**

The USDA's Agricultural Marketing Service (AMS) carries out inspection and grading services at tobacco auction markets and import terminals. The establishment of uniform standards of quality, with grading by unbiased experts, helps assure that auction markets perform efficiently and fairly. Federal grading also provides an assurance of quality for tobacco held as collateral for CCC price support loans. Additionally, imported and domestic tobacco is inspected to guard against illegal pesticide residues. Since 1981, the inspection and grading services have been financed through user fees (now set at \$1.00 per 100 pounds for domestic tobacco and \$0.45 per 100 pounds for imported tobacco). The amount of domestic tobacco that is federally graded has significantly declined as sales have shifted from auctions to direct contracting with buyers. In FY2002, the tobacco inspection and grading fees are budgeted to bring in about \$3.8 million, which is sufficient to fully cover the costs of inspection activities as well as the cost of developing and maintaining the standards applied by the inspectors.

## **Market News Services**

The Agricultural Marketing Service provides a market news service for sellers and buyers of tobacco. Daily reports of grades, prices, and sales volume at the auction markets are distributed throughout the tobacco industry. The cost of the tobacco news service in FY2002 is budgeted at \$1.178 billion. Similar market news services are provided for all major agricultural commodities. Market news services are designed to provide farmers, and others in the marketing chain, with timely, accurate, and unbiased information on market conditions, to help them make better decisions on where and when to sell and buy commodities. According to economists, such information is necessary for a market economy to function efficiently and effectively. In the absence of a taxpayer-funded market news service, the information might be collected and sold by commercial enterprises, but questions of bias could arise.

## **Tobacco Research**

In the past, USDA-funded research related to tobacco production, processing, and marketing. Some of the research was carried out by Agriculture Research Service (ARS) scientists and some was done by university scientists funded through the Cooperative State Research Service (CSRS).<sup>1</sup> Annual research spending by the USDA averaged about \$6.6 million until it was terminated under the FY1995 agricultural appropriations law and subsequent laws.

## **Extension Education**

The jointly funded federal-state-county extension education and technical assistance program is designed to serve as a link between the nation's agricultural research institutions and farmers. The term extension conveys the concept of extending the work of researchers into the community. At the county level, extension agents distribute

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<sup>1</sup> In 1994 USDA reorganization, CSRS and ARS were combined, along with the Extension Service, into the Cooperative State Research, Education & Extension Service (CSREES).

information and expert advice to farmers and others through published materials, seminars, and direct consultation. The state extension staff, given their close proximity to researchers, continuously train the county agents and design and prepare materials for use by the county agents. In FY1997, the Cooperative State Research, Education, and Extension Service (CSREES) spent \$680 thousand on tobacco-related extension activities. Federal funding was eliminated in FY1998 by the Administration and remains at zero. All state and county extension activity related to tobacco is funded by the states.

## **Economic Analysis**

The Economic Research Service (ERS) is responsible for assembling and analyzing economic data and forecasting market data within the USDA. As with the other major commodities, ERS assembles and analyzes supply and demand data on tobacco. ERS periodically publishes analytical findings in a Tobacco Situation and Outlook Report. Economists also conduct studies on related topics, such as the structural characteristics of tobacco farming, the role of tobacco in local economies, and the likely impact of program changes and policy options. ERS spending on tobacco analysis during FY2002 is budgeted at \$98,000.

## **International Data Collection and Analysis**

The Foreign Agriculture Service (FAS), through its network of agricultural counselors and attaches, collects economic intelligence throughout the world. This intelligence is used by trade negotiators, economists, policymakers, and the business community. Tobacco is one in a long list of commodities on which the FAS staff collects information. The USDA estimates that the cost of this effort for tobacco will be \$163,000 in FY2002.

## **Domestic Crop Data Collection**

The National Agricultural Statistics Service (NASS) collects field-level data on planting intentions, crop conditions, harvesting progress, yield, and production. This information helps the business community, including farmers develop marketing plans. Also, it serves to alert policy officials of likely shortages or surpluses, thereby facilitating plans for any government action that might be taken. The information that NASS compiles and distributes is considered by economists to be critical to an efficiently functioning market economy. It is argued that the absence of NASS data would most severely disadvantage farmers and government officials, who are least able to obtain information through alternative sources. Tobacco is one in a long list of commodities on which NASS staff collects information. The USDA budgeted the cost of this effort for tobacco at \$242,000 in FY2002.

This report will be updated and revised as new data become available and legislative events transpire.

**Table 1. USDA Tobacco-Related Net Budgetary Expenditures,  
Estimated FY2000 & Budgeted FY2001**

USDA Agency ▶ Activity or program	FY2001 Estimate \$000	FY2002 Budget \$000
Commodity Credit Corporation/Farm Service Agency		
▶ Administrative expenses of price support—salaries and office expenses of USDA tobacco program administrators.	16,372	17,288
▶ Tobacco price support loan operations—price support program loan outlays less repayments.	(202,220)	(96,875)
▶ Market loss payments—direct farm payments to compensate for quota reductions in 1999.	350,000	0
▶ Disaster payments.	0	0
Risk Management Agency		
▶ Crop insurance—tobacco crop loss indemnity payments and administrative expenses, less grower premiums.	33,657	34,637
Agricultural Marketing Service		
▶ Inspection & grading—inspection and grading for quality characteristics and pesticide residues provided on a fee-for-service basis.	0	0
▶ Market news reporting—collection and dissemination of auction market prices and sales volume data.	1,151	1,178
Cooperative State Research, Education, and Extension Service		
▶ Extension activities—extension education and technical assistance.	0	0
Economic Research Service		
▶ Economic analysis and projections—supply, demand, & trade analysis, and projections related to tobacco	98	98
Foreign Agricultural Service		
▶ World market analysis—collection and analysis of foreign country economic data on tobacco production and trade	155	163
National Agricultural Statistics Service		
▶ Agricultural statistics collection—data collection on U.S. tobacco acreage, crop condition, yield, and production.	241	242
Total USDA net expenditures for tobacco-related activities	199,454	(43,269)

**Source:** Data are from the USDA's Office of Budget and Program Analysis, Program-By-Program Summary, Estimated Costs Related to Tobacco Activities, May 7, 2001; and, the Farm Service Agency, Commodity Estimates Book FY2002, April 9, 2001.

**Note:** Numbers in parentheses are net revenues (i.e., negative net expenditures).